



A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

Montana State Lottery

*For the Two Fiscal Years Ended
June 30, 2017*

MARCH 2018

LEGISLATIVE AUDIT
DIVISION

17-30A

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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

The Single Audit Act Amendments of 1996 and the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards require the auditor to issue certain financial, internal control, and compliance reports in addition to those reports required by Government Auditing Standards. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2015, was issued March 29, 2016. The Single Audit Report for the two fiscal years ended June 30, 2017, will be issued by March 31, 2018.

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LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors
Cindy Jorgenson
Joe Murray

March 2018

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report of the Montana State Lottery (lottery) for the two fiscal years ended June 30, 2017. Our audit consisted of reviewing revenues, expenses, and account balances primarily related to online and scratch ticket sales. We reviewed the lottery's control systems and compliance with applicable state laws. The report resulted in no recommendations and an unmodified opinion, meaning the reader can rely on the information presented in the financial statements and notes.

The lottery's response to the audit is included on C-1 of the audit report. We thank the director and her staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

/s/ Angus Maciver

Angus Maciver
Legislative Auditor

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APPOINTED AND ADMINISTRATIVE OFFICIALS

			<u>Term Expires</u>
Montana State Lottery	Wilbur Rehmann, Chair	Helena	1/1/2021
	Jessika Kynett	Livingston	1/1/2021
	Thomas M. Keegan, Attorney at Law	Helena	1/1/2018
	Cindy Hiner	Deer Lodge	1/1/2018
	Leo Prigge, CPA	Butte	1/1/2019
Administrative Officials	Angela Wong, Montana State Lottery Director		
	Bryan Costigan, Montana State Lottery Director of Security		
	Armond Sergeant, Director of Financial Services		

For additional information concerning the Montana State Lottery, contact:

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MONTANA LEGISLATIVE AUDIT DIVISION

FINANCIAL-COMPLIANCE AUDIT

Montana State Lottery

For the Two Fiscal Years Ended June 30, 2017

MARCH 2018

17-30A

REPORT SUMMARY

In fiscal year 2016, a \$1.5 billion Powerball jackpot contributed to increased ticket sales. In fiscal year 2017, there were no significantly large jackpots. While this resulted in close to a \$7 million decline in on-line sales, Montana State Lottery still provided a \$9 million transfer to the General Fund which was approximately \$3 million less than fiscal year 2016. Net revenue is transferred to the General Fund per state law, §23-7-402, MCA. If net revenue exceeds a certain threshold, the additional amount is transferred to the Office of the Commissioner of Higher Education for Science, Technology, Engineering, and Math (STEM) scholarships. This threshold was not met in fiscal year 2017.

Context

The Montana State Lottery (lottery) offers both online and scratch games. Online games currently on sale include multi-state games such as Powerball, Mega Millions, Lucky for Life, and Hot Lotto, as well as state-specific games such as Montana Cash and Montana Millionaire. The lottery also markets an assortment of scratch games, as well as Treasure Play games, that are instant win games. In fiscal year 2017, sales from on-line and scratch games were approximately \$52.4 million and direct costs associated with the sales were approximately \$38.9 million. The lottery transferred \$9.2 million to the state's general fund in fiscal year 2017. Operating income was not sufficient in fiscal year 2017 per state law to require any transfers to the Office of the Commissioner of Higher Education to fund STEM scholarships. The lottery's operating expense, funded from the net proceeds from ticket sales, totaled \$4.4 million in fiscal year 2017.

We focused our audit efforts on sales revenues, direct game costs, and the account balances

associated with these activities as well as pension and other post-employment benefit (OPEB) liabilities. We specifically reviewed: scratch and online ticket revenues; direct game costs such as scratch and online ticket prize expenses, retailer commissions, and vendor fees; the estimated prize liability related to winning tickets sold but not claimed by fiscal year-end; cash and cash equivalents; accounts receivables associated with ticket sales at retailer locations; transfer activity required under state law, and personal services including pensions and OPEB. Throughout the audit, we reviewed the lottery's control systems, and determined compliance with state laws applicable to lottery.

Results

This report contains no recommendations to lottery and we issued an unmodified opinion meaning you can rely on the information presented on the financial statements and disclosed in the notes.

For a complete copy of the report (17-30A) or for further information, contact the
Legislative Audit Division at 406-444-3122; e-mail to lad@mt.gov; or check the web site at
<http://leg.mt.gov/audit>
Report Fraud, Waste, and Abuse to the Legislative Auditor's FRAUD HOTLINE
Call toll-free 1-800-222-4446, or e-mail lad@mt.gov.

Chapter I – Introduction

Introduction

We performed a financial compliance audit of the Montana State Lottery (lottery) for the fiscal year ended June 30, 2017, with comparative statements for the fiscal year ended June 30, 2016. The audit meets the requirements of §23-7-410, MCA, for the legislative auditor to conduct, or have conducted, an annual audit of the Montana State Lottery. The objectives of the audit were to:

1. Obtain an understanding of the lottery's control systems to the extent necessary to support our audit of the financial statements and, if appropriate, make recommendations for improvements in management and internal controls for the lottery.
2. Determine whether the lottery's financial statements present fairly the financial position, results of operations, and cash flows for the fiscal year ended June 30, 2017, with comparative financial statements amounts for the fiscal year ended June 30, 2016.
3. Determine whether the Montana State Lottery complied with selected state laws and regulations.
4. Determine the implementation status of the prior audit recommendation.

We addressed these objectives by focusing our audit efforts on the review of revenues, expenses, and account balances resulting from ticket sales. We specifically reviewed: scratch and online ticket revenues; direct game costs such as scratch and online ticket prize expenses, retailer commissions, and vendor fees; the estimated prize liability related to winning tickets sold but not claimed by fiscal year-end; accounts receivables associated with ticket sales at retailer locations; cash and cash equivalents; and transfer activity required under state law. We also reviewed the lottery's personal services expenses including the pension and other post-employment benefit (OPEB) liabilities. Throughout the audit, we reviewed the lottery's control systems, and determined compliance with applicable state laws.

Background

The lottery is established in state law, and governed by a five-member Lottery Commission (commission). Members of the commission are appointed by the governor to serve four-year staggered terms. The director of the lottery is also appointed by the governor. The commission is responsible for overseeing lottery operations and maximizing the net revenue earned by the lottery and paid to the state. The commission also sets the price of tickets and the number and size of prizes awarded for Montana specific lottery games. The commission is allocated to the Department of Administration (department) for administrative purposes. As such, the financial

activity of the lottery is also included in the states' Comprehensive Annual Financial Report and the department's audited financial schedules.

The lottery is a member of the Multi-State Lottery Association (MUSL), a nonprofit, government-benefit association. MUSL is owned and operated by member lotteries, and each state member lottery has a representative on the MUSL board of directors.

The MUSL Board develops rules and regulations for all member state lotteries regarding games operated by MUSL. The lottery must comply with these regulations as a condition of offering MUSL games such as Powerball.

During fiscal year 2017, the lottery offered scratch tickets, Powerball, Mega Millions, Lucky for Life, Montana Millionaire, Montana Cash, Hot Lotto, Treasure Play, Fantasy Football, Fantasy Racing and added Big Sky Bonus. Two games, Wild Card and 10 Spot ended in 2016. State law requires a minimum of 45 percent of money paid for tickets and chances on lottery games be used for prizes. Games sold in fiscal year 2017 had a composite prize payout of 58.34 percent.

The lottery accounts for its operations in an enterprise fund, which means that the operations are financed and operated similar to a private business enterprise where the intent is to finance or recover all costs through user charges. Funding for lottery operations comes from sales of lottery games.

Transfer Determination

Section 23-7-402(4), MCA, specifies the transfers of lottery net revenue. Generally Accepted Accounting Principles for financial reporting purposes requires the lottery to record its allocated share of OPEB and pension expenses, as well as the associated liabilities resulting from these benefits associated with their employees. As a result of combined pension and OPEB liabilities, the lottery has a negative net position. However, these items do not result in cash outflows from the lottery fund. The lottery and the department's State Financial Services Division determined the annual OPEB and pension expenses should not be included in the calculation of the net revenue transfer amounts. The financial statements included in this report reflect this methodology in calculation of the transfer amount. Our review of the methodology determined this calculation meets the intent of the law.

Prior Audit Recommendation

The prior audit report for the fiscal year ended June 30, 2016, contained one recommendation to the lottery. The recommendation to the lottery was to seek legal

review of changes in statutory requirements regarding transfers of its net revenues. There were no changes in statutory requirements effective in fiscal year 2017. However, the department corrected the general fund and STEM scholarship transfer amount for the error made in fiscal year 2016 as a result of law change effective during that year.

Independent Auditor's Report and Lottery Financial Statements

LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors
Cindy Jorgenson
Joe Murray

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

Introduction

We have audited the accompanying Statement of Net Position of the Montana State Lottery as of June 30, 2017, and 2016, the related Statement of Revenues, Expenses and Changes in Net Position, and the Statements of Cash Flows for each of the fiscal years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this responsibility includes designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the Montana State Lottery's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Montana State Lottery's internal control, and accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and

the reasonableness of significant accounting estimates made by management, as well as the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana State Lottery as of June 30, 2017, and 2016, and the changes in net position and cash flows for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 to the financial statements, the financial statements present only the enterprise fund of the Montana State Lottery and do not purport to, and do not, present fairly the financial position of the State of Montana, as of June 30, 2017, and 2016, the changes in its financial position, or its cash flows for each of the two fiscal years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 13, 2018, on our consideration of the Montana State Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Montana State Lottery's internal control over financial reporting and compliance.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

February 13, 2018

**MONTANA LOTTERY
STATEMENT OF NET POSITION
JUNE 30, 2017 AND 2016**

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	2017	2016
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 1,973,494	\$ 2,308,534
Receivables (Net)	1,750,221	2,140,199
Multi-State Reserve Fund	65,000	65,000
Inventories	512,292	435,336
Securities Lending Collateral	0	6,020
Prepaid Expenses	38,455	36,395
	<hr/>	<hr/>
TOTAL CURRENT ASSETS	4,339,462	4,991,484
NONCURRENT ASSETS		
Computer, Furniture & Equipment	570,815	538,153
Leasehold Improvements	98,793	59,781
Accumulated Depreciation	(402,645)	(461,917)
Multi-State Reserve Fund	1,028,333	1,121,635
	<hr/>	<hr/>
TOTAL NONCURRENT ASSETS	1,295,296	1,257,652
DEFERRED OUTFLOW OF RESOURCES		
Pension Deferred Outflows	320,057	218,447
	<hr/>	<hr/>
COMBINED ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	\$ <u>5,954,815</u>	\$ <u>6,467,583</u>
LIABILITIES		
CURRENT LIABILITIES		
Accounts Payable	\$ 285,856	\$ 835,894
Estimated Prize Liability	2,618,688	2,522,426
Transfer Obligations	1,480,492	1,527,596
Liability under Security Lending	0	6,020
Unearned Revenue	95,986	104,297
Accrued Compensated Absences	201,653	133,730
	<hr/>	<hr/>
TOTAL CURRENT LIABILITIES	4,682,675	5,129,963
NONCURRENT LIABILITIES		
Multi-State Prize Liability	952,083	1,016,794
Accrued Compensated Absences	0	102,379
Net Pension Liability	1,967,263	1,651,762
Other Post Employment Benefits	731,049	663,958
	<hr/>	<hr/>
TOTAL NONCURRENT LIABILITIES	3,650,395	3,434,893
DEFERRED INFLOWS OF RESOURCES		
Pension Deferred Inflows	11,855	142,273
	<hr/>	<hr/>
COMBINED LIABILITIES AND DEFERRED INFLOW OF RESOURCES	8,344,925	8,707,129
NET POSITION		
Net Investment in Capital Assets	266,963	136,017
Unrestricted	(2,657,073)	(2,375,563)
	<hr/>	<hr/>
TOTAL NET POSITION	\$ <u>(2,390,110)</u>	\$ <u>(2,239,546)</u>

The accompanying notes are an integral part of these financial statements.

<p style="text-align: center;">MONTANA LOTTERY STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION FOR THE YEARS ENDED JUNE 30, 2017 AND 2016</p>
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	2017	2016
OPERATING REVENUES:		
Scratch Ticket Revenue	\$ 17,097,062	\$ 17,813,988
On Line Ticket Revenue	35,344,867	41,886,531
License, Permits, and Misc	<u>18,275</u>	<u>26,571</u>
Total Operating Revenues	52,460,204	59,727,090
DIRECT GAME COSTS:		
Scratch Ticket Prize Expense	10,497,914	10,722,806
On Line Ticket Prize Expense	20,096,926	22,955,042
Retailer Commissions	2,981,078	3,499,035
Cost of Tickets Sold	1,018,794	981,044
Vendor fees	<u>4,353,879</u>	<u>3,861,429</u>
Total Direct Game Costs	38,948,591	42,019,356
Income Before Operating Expenses	13,511,613	17,707,734
OPERATING EXPENSES:		
Advertising	598,988	583,065
Advertising Production	239,952	248,819
Audit Fees	26,409	79,282
Bad Debts Expense	123	4,652
Communications	147,116	136,346
Contractual Services	243,695	263,549
Depreciation and Amortization	46,798	167,157
Interest	0	1,297
Administrative Service Fee	73,734	76,538
Multi-State Dues	29,417	96,001
Public Relations	66,703	53,748
Other Post Employment Benefits	88,983	88,769
Other Expenses	36,690	36,640
Pension Expense	179,560	141,852
Personal Services	2,113,436	2,092,101
Repairs and Maintenance	30,290	31,634
Supplies and Materials	244,358	273,045
Travel	42,722	53,300
Utilities and Rent	<u>217,519</u>	<u>519,797</u>
Total Operating Expense	4,426,493	4,947,592
Operating Income	9,085,120	12,760,142
NONOPERATING REVENUES (EXPENSES):		
Interest Earnings	12,542	10,625
Security Lending Income	35	340
Security Lending Expense	(16)	(17)
Non Employer Pension Revenue	34,467	40,722
Gain/Loss on Sale of Assets	<u>(1,711)</u>	<u>(234,961)</u>
Total Nonoperating Revenues(Expenses)	<u>45,317</u>	<u>(183,291)</u>
Income Before Operating Transfers	9,130,437	12,576,851
Operating Transfers Out - General Fund	(9,224,231)	(12,363,365)
Operating Transfers Out - Other Agencies	0	(523,506)
CHANGE IN NET POSITION	(93,794)	(310,020)
Total Net Position, Beginning of Period	(2,239,546)	(1,929,526)
Prior Period Adjustment (Note 2)	<u>(56,770)</u>	<u>0</u>
TOTAL NET POSITION, END OF PERIOD	\$ <u>(2,390,110)</u>	\$ <u>(2,239,546)</u>

The accompanying notes are an integral part of these financial statements.

<p style="text-align: center;">MONTANA LOTTERY STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2017 AND 2016</p>

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts for Sales & Services	\$ 52,841,748	\$ 59,430,249
Payments for Goods & Services	(10,980,398)	(10,444,363)
Payments to Employees	(2,288,174)	(2,231,728)
Payments for Prizes	(30,563,289)	(33,421,156)
Net Cash Provided by Operating Activities	<u>9,009,887</u>	<u>13,333,002</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Transfer to Other Funds	(9,271,335)	(14,423,995)
Net Cash Used For Noncapital Financing	<u>(9,271,335)</u>	<u>(14,423,995)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition of Fixed Assets	(198,386)	(46,236)
Proceeds from Sale of Fixed Assets	18,931	0
Principal & Interest Payment on Leases	0	(55,423)
Net Cash Used For Capital Financing	<u>(179,455)</u>	<u>(101,659)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest and Dividends on Investments	12,561	10,948
Received from (Paid to) MUSL Prize Reserve Fund	93,302	180,835
Sale (Purchase) of long term investments	0	20,773
Net Cash Provided by Investing Activities	<u>105,863</u>	<u>212,556</u>
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	<u>(335,040)</u>	<u>(980,096)</u>
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>2,308,534</u>	<u>3,288,630</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 1,973,494</u>	<u>\$ 2,308,534</u>
 Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating Income	\$ 9,085,120	\$ 12,760,142
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities		
Depreciation	46,798	167,157
Interest Expense	0	1,297
Change in Assets and Liabilities:		
Decr (Incr) in Account Receivable	389,978	(293,476)
Decr (Incr) in Inventories	(76,956)	(73,546)
Decr (Incr) in Collateral securities on loan	6,020	(426)
Decr (Incr) in Prepaid expenses	(2,060)	(19,273)
Incr (Decr) in Accounts Payable	(550,038)	441,728
Incr (Decr) in Lottery Prizes Payable	31,551	256,692
Incr (Decr) in Liability for securities on loan	(6,020)	426
Incr (Decr) in Unearned Income	(8,311)	1,287
Incr (Decr) in Other Post Employment Benefits	67,091	66,714
Incr (Decr) in Pension Liability	61,170	19,659
Incr (Decr) in Compensated Absences Payable	(34,456)	4,621
Total Adjustments	<u>(75,233)</u>	<u>572,860</u>
Net Cash Provided by Operating Activities	<u>\$ 9,009,887</u>	<u>\$ 13,333,002</u>

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
Notes to the Financial Statements
June 30, 2017 and 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity.

The Montana Lottery, established under the provisions of Section 23-7-101, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets went on sale June 24, 1987.

The Montana Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games in conjunction with other lottery states and countries, and prepare financial reports. The Montana Lottery is attached to the Montana Department of Administration for administrative purposes.

The Montana Lottery is included as an enterprise fund in the State of Montana's Comprehensive Annual Financial Report. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Montana Lottery's financial statements as a reporting entity.

Basis of Presentation. The Montana Lottery reports its financial activity in accordance with generally accepted accounting principles (GAAP) as prescribed in pronouncements of the Governmental Accounting Standards Board (GASB).

Enterprise Fund. The Montana Lottery is classified as an Enterprise Fund of the Proprietary Fund Type. Enterprise Funds account for operations: a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Basis of Accounting. The Montana Lottery's financial statements are prepared using the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable.

Property and equipment. Property and equipment are recorded at cost. Donated property and equipment are recorded at their estimated fair market value at the date of donation. Ordinary maintenance and repairs are charged to operations as incurred; major renewals and betterments are capitalized. Upon disposition or retirement of property and equipment, the cost and related accumulated depreciation or amortization are removed from the accounts. Gain or loss on disposal is reflected in non-operating revenues and expenses. Depreciation and amortization are calculated on a straight-line basis over estimated useful lives of three to ten years. The Lottery conforms to the State of Montana capitalization threshold for capitalizing property and equipment as well as buildings and building/land improvements. The threshold for capitalizing property and equipment is \$5,000 and the threshold for capitalizing buildings/land improvements is \$25,000.

Revenue Recognition. Lottery scratch ticket sales are recorded as revenue based on the time the retailer activates the pack of tickets for sale. In accordance with an established policy, retailers may return unsold tickets to the Lottery for credit. Sales are decreased by an allowance for estimated ticket returns.

Ticket sales for lotto games Powerball, Wild Card, Montana Cash, Hot Lotto, Montana Millionaire, Mega Millions, Lucky for Life, Big Sky Bonus, and 10 Spot are recorded as revenue based on drawings. Tickets sold in advance for future drawings are recorded as unearned income until such time as the tickets become valid for the most current drawing.

Treasure Play revenue is recorded on a daily basis as games are played. Treasure Play games are instant chances for wins, so when these games are played the revenue from these games are earned as played.

Ticket sales for Fantasy Sports games are based upon MCA 23-4-302 and an interagency agreement between the Lottery and the Board of Horse Racing. The Lottery is only a facilitator of these games and charges an administrative fee for this service. The actual sales of these games are not reflected on the Lottery's financial statements as they are not income to the Lottery.

Classification of Revenues. The Lottery has classified its revenues as either operating or non-operating according to the following criteria:

Operating revenues – include activities that have characteristics of exchange transactions, including (1) ticket sales, net of returns, and (2) retailer license fees and administrative fees in relation to selling lottery tickets.

Non-Operating revenues – include activities that have the characteristics of non-exchange transactions, such as gifts and other revenue sources that are defined as non-operating revenues by GASB No. 9, “Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting,” and GASB No. 34, “Basic Financial Statements and Management Discussion and Analysis for State and Local Governments.” Types of revenue sources that fall into this classification are investment income, and gain or loss on disposition of assets.

Free Tickets. Some Montana Lottery scratch games award free tickets as prizes. Net lottery ticket revenue does not include the value of free tickets given away and free plays won. The face value of these free ticket prizes distributed for the year ended June 30, 2017, and 2016 was \$624,380, and \$450,120, respectively.

Promotional Credits. The Lottery issues promotional credits to retailers to be used to distribute free tickets to players. The tickets are distributed as part of a promotion run by the retailer, e.g., “Ask for the Sale” or second chance drawings. The Lottery also directly distributes scratch tickets for promotional purposes at trade shows, for media give-aways, and during new game introductions. The tickets distributed as a result of promotional credits are reflected as a reduction in revenue. The related prize expense and ticket cost for all promotions are reclassified as an advertising expense. For the year ended June 30, 2017, promotional credits resulted in a revenue reduction of approximately \$29,730 and an expense reclassification of approximately \$20,029. For the year ended June 30, 2016, promotional credits resulted in a revenue reduction of approximately \$23,236 and an expense reclassification of approximately \$17,460.

Prizes. Expenses for scratch prizes are recorded based on the predetermined prize structure for each game. Expenses for lotto prizes are recorded based on the predetermined prize structure for each individual game. No prize expense is recorded for free tickets distributed.

Unclaimed Prizes. Prizes for the lotto games must be claimed within six months after the appropriate draw date. Prizes for scratch games must be claimed within six months of the announced end of each game. The unclaimed prize amounts for these games are taken as a reduction in the Lottery Prizes Payable liability and the Prize Expense and are transferred to the State of Montana General Fund as a portion of the quarterly transfer. The amount of unclaimed prizes for all Montana Lottery games is represented in the table below.

	Quarter Ended 6/30/17	Quarter Ended 6/30/16	Year to Date 6/30/17	Year to Date 6/30/16
Lotto	\$122,496	\$139,205	\$ 763,255	\$ 540,754
Scratch	\$285,889	\$375,354	\$ 825,586	\$ 914,062
TOTALS	\$408,385	\$514,559	\$1,588,841	\$1,454,816

2. OTHER ACCOUNTING ISSUES

New Accounting Guidance. Beginning fiscal year ended June 30, 2016, the Montana Lottery implemented GASB Statement 72, Fair Value Measurement and Application. In accordance with this statement, certain assets have been presented at fair value and the appropriate disclosures are included.

Change in Accounting Method. It was determined that state statutes did not intend to include any pension expense or revenue when determining the amount of transfers for any year. This expense is now disregarded and added or subtracted to the change in net position on the Statement of Revenues, Expenses, and Changes in Net Position. As a result of this change, the transfer amounts were decreased by net pension revenue during fiscal year ended June 30, 2016. The amount of the decrease was \$21,063 in FY2016.

Prior Period Adjustment. The prior period adjustments for the year ended June 30, 2017, were made by the State Accounting Bureau for changes made to the Lottery's pension accounts. These adjustments were made to account for a change in methodology used to allocate the pension figures amongst multiple funds within a single business unit at the State level. An increase was made to the Pension Deferred Outflows for \$30, an increase of \$11,655 was made to the Pension Deferred Inflows, and an increase was made to the Net Pension Liability for \$45,145. The result of the above equates to a \$56,770 reduction to the Lottery's Net Position.

3. SUMMARY OF ACCOUNTS

Cash and Cash Equivalents. Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investment pool; cash on deposit in a revolving account with an approved non-state financial institution; and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Cash and cash equivalents consist of the following:

	June 30,	
	<u>2017</u>	<u>2016</u>
Short-term investment pool	\$1,439,929	\$1,428,495
Cash on deposit with State Treasurer	523,365	869,839
Cash in revolving deposit account	10,000	10,000
Petty Cash & Cash On-Hand	200	200
TOTALS	\$1,973,494	\$2,308,534

The bank balance of the revolving deposit account, not including outstanding deposits or checks, was \$10,438, and \$17,400 as of June 30, 2017 and 2016, respectively, and was covered by federal depository insurance. The carrying amount reported in the balance sheet for cash and cash equivalents approximates the fair market value.

Receivables. For the year ended June 30, 2017, receivables include \$1,994,028, representing amounts due the Lottery for tickets purchased by retailers. Receivables also include \$1,281 for interest income due from the Montana Board of Investments short-term investment pool. An allowance for ticket returns is included in the receivables amount. This allowance represents a reduction in receivables as of June 30, 2017, for estimated ticket returns. This is an estimate based on returns received to date, as well as an estimate of tickets unsold by retailers for games that have a public sale end date prior to July 1, 2017. The allowance for ticket returns is \$267,827 as of June 30, 2017. The return of vendor fees related to the allowance for returns is \$22,739.

For the year ended June 30, 2016, receivables included \$2,367,610, representing amounts due the Lottery for tickets purchased by retailers. Receivables also include \$980 for interest income due from the Montana Board of Investments short-term investment pool. An allowance for ticket returns is included in the receivables amount. This allowance represents a reduction in receivables as of June 30, 2016, for estimated ticket returns. This is an estimate based on returns received to date, as well as an estimate of tickets unsold by retailers for games that have a public sale end date prior to July 1, 2016. The allowance for ticket returns is \$249,580 as of June 30, 2016. The return of vendor fees related to the allowance for returns is \$21,189.

Inventories. Inventories consist of merchandise and supplies inventories. Merchandise inventory for years ended June 30, 2017 and 2016 include scratch tickets valued at \$460,462, and \$337,628, respectively, that are stored in the warehouse, at retailers prior to being activated by the retailer, and with the marketing representatives. These ticket inventories are recorded at cost using the specific identification method and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold upon activation or after game end.

Supplies inventories include ticket dispensers, premiums and point-of-sale materials. For the years ended June 30, 2017, and 2016, supplies inventories totaled \$51,830, and \$97,708, respectively. These inventories are also recorded at cost using the specific identification method.

Other Current Assets. Other current assets include the following:

	June 30,	
	<u>2017</u>	<u>2016</u>
Prepaid Expenses	\$38,455	\$36,395

The prepaid expenses for the year ended June 30, 2017 consisted of \$5,250 for booth fees for upcoming events, \$20,000 in annual lottery industry dues, \$256 in employee advances, and \$12,949 for prepaid commissions and vendor fees related to unearned income. The prepaid expenses for the year ended June 30, 2016 consisted of \$6,325 for booth fees for upcoming events, \$16,000 in annual lottery industry dues, and \$14,070 for prepaid commissions and vendor fees related to unearned income.

Property and Equipment. A summary of property and equipment for the Lottery for both years is as follows:

	June 30, 2015	Additions	Deletions	June 30, 2016
Leasehold Improvements	\$ 59,781	\$ -	-	\$ 59,781
Furniture & Equipment	\$ 2,981,645	\$ 46,236	\$(2,489,728)	\$ 538,153
Accumulated Depreciation	\$(2,549,526)	\$(167,157)	\$ 2,254,766	\$ (461,917)
	June 30, 2016	Additions	Deletions	June 30, 2017
Leasehold Improvements	\$ 59,781	\$ 39,012	-	\$ 98,793
Furniture & Equipment	\$ 538,153	\$159,374	\$(126,712)	\$ 570,815
Accumulated Depreciation	\$ (461,917)	\$ (46,798)	\$ 106,070	\$ (402,645)

During the year ended June 30, 2016, the contract with the Lottery's on-line services vendor ended. This contract ended on March 30, 2016 and included the lease arrangements for various terminal machines. The leases and ownership of all terminal equipment ceased as of this date and were disposed of by the Lottery. The cost of this equipment disposed was \$2,463,200 with a related accumulated depreciation of \$2,231,669. There were no proceeds received for these machines as they were mostly obsolete and were physically disposed of by the vendor at their own cost. The transaction created a net loss of \$231,531 which consisted primarily of salvage value kept on the books as required by State policy.

Estimated Prize Liability. The estimated prize liability represents the Lottery's estimate of prizes payable related to games in process at year-end based on the predetermined prize structure of each outstanding game.

Obligation to Transfer Funds. The Lottery is required to transfer its net revenue to the Montana State General Fund. This change was enacted through the passage of SB83 by the 1995 Legislature and signed into law by Governor Racicot in April 1995. The 2015 Legislature passed HB617 which changed the transfer requirements. Any year forward, the Lottery is to transfer an amount to the General Fund that equals the transfer made by the Lottery for FY2015. Any amount over and above this threshold will then be transferred to the Office of Commissioner for Higher Education (OCHE) for the Montana STEM scholarship program. The transfer obligations outstanding at June 30, 2017 were \$1,480,492 to the General Fund and \$0 to OCHE. For the year ending June 30, 2016, the obligation outstanding at year end was \$1,404,090 due to the General Fund and \$123,506 to OCHE.

Compensated Absences. State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Vacation leave may be accumulated not to exceed two times the maximum number of days earned annually. With no limit on accumulation, sick leave is earned at 12 days per year. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave. The Lottery's liability for compensated absences is detailed below.

Balance	Net Leave	Balance
<u>June 30, 2015</u>	<u>Earned/(Used)</u>	<u>June 30, 2016</u>
\$231,488	\$4,621	\$236,109
Balance	Net Leave	Balance
<u>June 30, 2016</u>	<u>Earned/(Used)</u>	<u>June 30, 2017</u>
\$236,109	\$(34,456)	\$201,653

Non-Current Liabilities. Following are the changes in non-current liabilities for the years ended June 30, 2017 and 2016:

Year ended June 30, 2017					
	Balance			Balance	Amounts
	<u>July 1, 2016</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2017</u>	<u>due within</u>
					<u>one year</u>
Multi-State Prize Liability	\$1,016,794	\$ 10,368	\$ (75,079)	\$ 952,083	\$ -
Accrued Compensated Absences	\$ 102,379	\$ 40,241	\$(142,620)	\$ -	\$ -
Net Pension Liability	\$1,651,762	\$481,540	\$(166,039)	\$1,967,263	\$ -
Other Post Employment Benefits	\$ 663,958	\$ 111,105	\$(44,014)	\$ 731,049	\$ -

Year ended June 30, 2016					
	Balance			Balance	Amounts
	<u>July 1, 2015</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2016</u>	<u>due within</u>
					<u>one year</u>
Multi-State Prize Liability	\$1,148,771	\$ 14,670	\$(146,647)	\$1,016,794	\$ -
Accrued Compensated Absences	\$ 73,553	\$ 65,638	\$(36,812)	\$ 102,379	\$ -
Net Pension Liability	\$1,370,034	\$445,307	\$(163,579)	\$1,651,762	\$ -
Other Post Employment Benefits	\$ 597,244	\$108,918	\$(42,204)	\$ 663,958	\$ -

Commissions. Section 23-7-301(10), MCA, provides retailers a commission on scratch and lotto tickets or chances sold. The Lottery Commission established this commission at 5% of the face value of scratch tickets activated by the retailers and the face value of lotto tickets sold. Section 23-4-302 (5)(b)(i), MCA, establishes a 3.99% commission for the face value of Fantasy Sports tickets sold. In addition retailers can earn bonus commissions on tickets sold based on incremental sales of scratch tickets. For the years ended June 30, 2017 and 2016, retailers earned bonus commissions of \$332,840 and \$479,473, respectively. For the years ended June 30, 2017 and 2016, total commissions were \$2,981,078 and \$3,499,035, respectively.

4. PAYMENTS TO OTHER STATE AGENCIES

The Lottery receives a variety of services, supplies, and materials from other state agencies. These services and materials are detailed below for the fiscal years ended June 30, 2017 and 2016:

Year Ended June 30	2017	2016
Administrative Service Fees	\$73,734	\$76,536
Audit Fees	26,409	79,282
Computer Fees	79,633	65,766
Insurance	12,874	13,518
Mail Processing Fees	11,066	9,705
Other Expenses	5,450	2,430
Payroll Services	7,026	7,009
Printing	6,265	5,372
Record Retention	1,018	1,018
State Accounting System Support	4,013	4,158
Supplies & Materials	247	59
Telecommunications	10,598	11,437
Warrant Writing Services	1,013	280
	<u>\$239,346</u>	<u>\$276,570</u>

5. PRIZES

Paid Prizes. Section 23-7-402, MCA states, "A minimum of 45% of the money paid for tickets or chances must be paid as prize money". Prize expense is recorded based on the predetermined prize structure percentage for each game less unclaimed prizes. For the year ended June 30, 2017, the prize expense of \$30,594,840 is 58.34% of net Lottery ticket revenue of \$52,441,929. For the year ended June 30, 2016, the prize expense of \$33,677,848 was 56.41% of net Lottery ticket revenue of \$59,700,519.

6. TRANSFERS OF NET REVENUE

Section 23-7-402(3), MCA, states "That part of all gross revenue not used for payment of prizes, commissions, and operating expenses, together with the interest earned on the gross revenue while the gross revenue is in the enterprise fund, is net revenue. Net revenue must be transferred quarterly from the enterprise fund established by 23-7-401 to the state general fund. Once the amount of revenue transferred to the general fund during a fiscal year equals the amount transferred to the general fund in fiscal year 2015, any additional net revenue must be transferred to the Montana STEM scholarship program special revenue account established in 20-26-617. For the years ended June 30, 2017 and 2016, the net revenue payable to the State General Fund totaled \$9,224,231, and \$12,363,365, respectively. For the years ended June 30, 2017 and 2016, the net revenue payable to the Montana STEM scholarship totaled \$0, and \$523,506, respectively.

7. MULTI-STATE LOTTERY

In November 1989 the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. Powerball, Wild Card, Hot Lotto, and Mega Millions are the games jointly operated by the members, in which Montana presently participates. Each lottery participating in MUSL is represented on the Board of Directors.

The Multi-State Lottery Reserve Fund with a balance of \$1,093,333 and \$1,186,635 as of June 30, 2017, and 2016, respectively, is comprised of several reserve accounts, which are maintained by the Multi-State Lottery Association (MUSL). A portion of the Powerball Unreserved Account is classified as a current asset which represents an amount expected to be converted into cash and collected from MUSL within the next fiscal year. The balance of these reserve accounts and investment category is as follows:

	<u>June 30, 2017</u>		
	US	Federal	Total
	Treasury	Agencies	
Powerball Prize Reserve Account	\$343,544	\$ 55,926	\$ 399,470
Powerball Set Prize Reserve Account	44,637	129,046	173,683
Powerball Unreserved Account	20,382	120,868	141,250
Hot Lotto Set Prize Reserve Account	-	238,527	238,527
Mega Millions Prize Reserve Account	<u>113,081</u>	<u>27,322</u>	<u>140,403</u>
Total Reserves	<u>\$521,644</u>	<u>\$571,689</u>	<u>\$1,093,333</u>
Less Current Portion			(65,000)
Non Current Reserves			<u>\$1,028,333</u>

	<u>June 30, 2016</u>		
	US	Federal	Total
	Treasury	Agencies	
Powerball Prize Reserve Account	\$329,685	\$ 93,313	\$ 422,998
Powerball Set Prize Reserve Account	50,870	133,042	183,912
Powerball Unreserved Account	13,570	156,270	169,840
Hot Lotto Set Prize Reserve Account	-	264,764	264,764
Mega Millions Prize Reserve Account	<u>113,107</u>	<u>32,014</u>	<u>145,121</u>
Total Reserves	<u>\$507,232</u>	<u>\$679,403</u>	<u>\$1,186,635</u>
Less Current Portion			<u>(65,000)</u>
Non Current Reserves			<u>\$1,121,635</u>

The Powerball Prize Reserve Account is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund would be returned to the Lottery one year after the Lottery leaves the Powerball game, assuming that no unanticipated prize claims have been paid.

The Powerball Set Prize Reserve Account is used to fund prize payments for current drawings. Since the Powerball game has fixed prizes, it is often necessary to draw from this reserve to fund payment of prizes at the fixed amount. This account would be returned to the Lottery upon withdrawal from the Powerball game.

The Lottery contributes to these reserve funds through the 50% set aside for prizes. In addition the Lottery was required to contribute for its portion of the reserve funds accumulated since the start of the Powerball game. Payments made to this fund are considered a portion of prize expense associated with the game.

The Powerball Unreserved Account is a separate account used by a participating Lottery to have MUSL hold funds due to the Lottery. Balances in this account are created when any MUSL jackpot expires and goes unclaimed. Each Lottery is then refunded its pro rata share of the jackpot based on sales during the accumulation of that specific jackpot. This money is then invested in U.S. Treasury securities until withdrawn. Interest earned on the Lottery's share of the fund is added to the Unreserved Account on a quarterly basis. The amount in the Unreserved Account has limited uses and are set and approved by the Board with the stipulation that requests to use the funds are accompanied by certification

from the requesting Board Member that the payment is made in conformance with state or jurisdiction law and is related to a MUSL activity.

During fiscal year ended 2017, the Lottery received \$827 in interest, and had \$29,417 withdrawn for annual MUSL dues and assessments. During the fiscal year ended 2016, the Lottery received \$1,006 in interest plus received \$44,307 in distributions from the Wild Card Reserve, \$4,646 from the Powerball Set Prize Reserve, \$1,223 from the Mega Millions Reserve, and had \$100,040 withdrawn for annual MUSL dues and assessments.

The Wild Card Reserve Account was to be used in the event of an unanticipated prize claim on the Wild Card game. This account was also administered by MUSL and would be returned to the Lottery one year after the Wild Card Product Group of Idaho, Montana, South Dakota, and North Dakota is disbanded. The Lottery contributed to this account through the 57% set aside for prizes. Payments made to this fund were considered a portion of prize expense related to the Wild Card game. The Wild Card game ended February 24, 2016.

The Hot Lotto Set Prize Reserve Account is administered by MUSL and is to be used only in the event of unanticipated prize claims. Like other MUSL games the reserve amount would be returned to the Lottery one year after withdrawal from the Hot Lotto game. The Lottery contributes to the reserve through the 50% set aside for prizes. Payments made to the reserve are considered a portion of the prize expense related to the game.

The Mega Millions Prize Reserve Account is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund would be returned to the Lottery one year after the Lottery leaves the Mega Millions game, assuming that no unanticipated prize claims have been paid. The Lottery contributes to the reserve through the 50% set aside for prizes for Mega Millions plays and 50% for Megaplier plays. Payments made to the reserve are considered a portion of the prize expense related to the game.

8. GAMES

Currently, Montana Lottery games are Scratch ticket games and ten Lotto games referred to as Powerball, Montana Cash, Wild Card, Hot Lotto, Mega Millions, Lucky for Life, Big Sky Bonus, and 10 Spot. The Lottery also offers Treasure Play, a line of instant terminal-issued games with pre-determined odds, and Montana Millionaire, a limited-edition Lottery game. The Lottery is facilitating Fantasy Sports games on behalf of the Board of Horse Racing. Currently the Lottery is selling Montana Sports Action Fantasy Football and Fantasy Racing games.

Scratch ticket games provide players the opportunity to win instantly by scratching the latex covering to reveal a prize. The lottery sells tickets for \$1, \$2, \$3, \$5, \$10, and \$20. Cash prizes range from \$1 to \$500,000, plus specialty prizes for certain games.

The Powerball game allows players a chance to win a minimum parimutuel jackpot of \$40 million. A player must match all six numbers to win the jackpot. Players also win prizes ranging from \$4 to \$1 million for matching fewer than all six numbers. Drawings are held twice weekly on Wednesday and Saturday nights. Powerball is offered in 45 lottery jurisdictions including Montana. For any drawing, if no ticket matches 6 out of 6 numbers, the jackpot rolls over to the next drawing, creating a progressive jackpot. In March 2001, the Lottery added Power Play to the Powerball game. For an additional \$1 per play, Power Play doubles the Match 5 prize from \$1 million to \$2 million and increases other prizes as well. Each Powerball prize (except for the jackpot and the Match 5 prize) increases by 2x, 3x, 4x, 5x, or 10x with Power Play.

The Montana Cash game allows players the chance to win a minimum parimutuel jackpot of \$40,000. Players select five numbers from a field of 45 and must match at least two out of five to win a prize. Matching 2 of 5 wins \$1, 3 of 5 wins \$5, and 4 of 5 wins \$200. The drawings are conducted twice weekly on Wednesday and Saturday nights. If no ticket matches all five numbers, the jackpot rolls over to the next drawing to create a progressive jackpot.

Wild Card is played in four lottery jurisdictions and allows players the chance to win a parimutuel jackpot with a guaranteed minimum of \$200,000. In January 2013, the game was improved by increasing the minimum jackpot from \$100,000 and increasing other prizes as well. Players select five numbers from a field of 33 plus one of 16 face cards (the Wild Card) and must match all five numbers and the Wild Card to win the jackpot. Players win prizes from \$1 to \$6,000 for matching fewer than all five numbers and/or the Wild Card. Drawings are held twice weekly on Wednesday and Saturday nights. If no ticket

matches all five numbers and the Wild Card, the jackpot rolls over to the next drawing to create a progressive jackpot. This game ended on February 24, 2016.

Hot Lotto allows players in the 16 participating lotteries a chance to win an all-cash parimutuel jackpot with a guaranteed minimum of \$1 million, plus tax withholdings paid. This change was implemented in May 2013. Each time the jackpot is not won, it grows, thus creating a progressive jackpot. Players choose five numbers from one to 47, and one Hot Ball number from 1 to 19. To win the parimutuel jackpot, a player must match all six numbers drawn. Players can also win prizes from \$2 to \$30,000 by matching fewer than all six numbers. If a player chooses, they can add Sizzler to their ticket for \$1. This multiplies any prize by three, except the jackpot. Drawings are held twice weekly on Wednesday and Saturday nights.

Mega Millions is a multi-state game that allows players to win a minimum parimutuel jackpot starting at \$15 million. If no one wins the jackpot, the jackpot continues to grow. Mega Millions went on sale March 1, 2010, in Montana. To win the jackpot, players must match all six numbers drawn; other prizes range from \$2 to \$1,000,000. For an additional \$1 per play, Mega Millions has a Megaplier option which multiplies non-jackpot prizes by two, three, or four. Drawings are held each Tuesday and Friday night.

10 Spot, which went on sale February 1, 2010, is a Montana-only, twice-daily game. Players select 10 numbers from one through 80. The lottery draws 20 numbers, and players win by matching 10, nine, eight, seven, six, five, or none of the numbers drawn. Prizes range from \$2 to \$25,000. This game ended on April 2, 2016.

Lucky for Life debuted January 2015. Lucky for Life is a multi-state game that allows players to win a top prize of \$1,000 a day for life. The second prize is \$25,000 a year for life. This pari-mutuel game has a set top prize and tickets cost \$2 each. Players select five numbers from a field of 48 and must match at least the Lucky Ball to win a prize. The drawings are conducted twice weekly on Monday and Friday nights.

Big Sky Bonus is the newest Montana Lottery game. Big Sky Bonus is a Montana-only game that allows players to win a progressive jackpot. Players select 4 numbers from a field of 28 and must match at least 2 out of 4 to win a prize unless they hit the bonus number which is a 5th number picked out of a field of 17. Matching the bonus number at any time wins \$10. Matching 2 of 4 wins \$2, 3 of 4 wins \$20, and 4 of 4 wins the jackpot. The drawing is held every day at 7:30 p.m. If no ticket matches all 4 numbers, the jackpot rolls over to the next day to create a progressive jackpot.

The Treasure Play games are offered on self-serve terminals in taverns and casinos that are licensed to sell Montana Lottery products. Introduced in November 2011, they are a suite of games with a pre-determined prize structure like a Scratch game. Players can tell instantly if they have won a prize. The tickets sell for \$1, \$2, \$3, \$5, and \$10.

Montana Millionaire is a seasonal raffle-type game offering a \$1 million top prize. The first offering went on sale October 1, 2007. The lottery has sold the game every winter since. Tickets are sold sequentially and are sold for \$20 each. Early bird drawings for \$25,000 and \$15,000, respectively, will be offered on Thanksgiving weekend and the second week of December to stimulate early sales. There will also be 400 \$100 instant winners and 625 \$500 instant winners. On January 1, 2017, one \$1 million prize was awarded, along with three \$100,000 prizes and five \$10,000 prizes. Montana Millionaire is scheduled to sell from November 1 through December 31, 2017, with a drawing on New Year's Day 2018 or earlier if it is sold out.

The Montana Lottery offers a product line called Montana Sports Action on behalf of the Montana Board of Horse Racing. The product line began in August 2008 with a game called Fantasy Football. To play the game, players choose five offensive players and a defensive unit from the official roster of professional football players and teams. The players can also select a bet amount (\$5, \$10, \$20, \$50, or \$100) which determines the shares of the prize pool players are eligible to win should their team have one of the three highest point totals for the week. Tickets are sold weekly through the professional playoffs, excluding the championship game. A second game called Fantasy Racing was introduced in February 2009 and follows the NASCAR® Sprint Cup Series. Teams are created by selecting a driver from the top nine ranked drivers for the week, three drivers ranked from 10 through 34, and one driver ranked 35 or above. The sixth element in a player's Fantasy Racing team is the number of yellow-flag cautions the player believes might occur in that week's race. Like Fantasy Football, players may also choose to purchase a higher-cost ticket to increase the share of the prize pool in the event their team has one of the three highest point totals for that race.

9. COMMITMENTS - GAMING SUPPLIER CONTRACTS

Scratch Tickets. On July 30, 2015 the Montana Lottery Commission approved the award of a five-year contract with Scientific Games International (SGI) for the provision of scratch tickets. The contract is for five years with the option for two additional one-year renewals. The contract contains specifications regarding ticket design, printing, game ownership, inspection, and prize structure.

SGL, as the vendor, provided a performance bond covering the contract term and an errors and omissions policy covering an ultimate net loss of \$5,000,000. The Lottery may terminate this contract by providing proper notification to Scientific Games.

On-line Services. On February 13, 2015, the Lottery signed a seven-year contract with Intralot, Inc. of Duluth, GA to provide an on-line gaming system and the associated services beginning March 31, 2016. The contract requires Intralot to provide new terminals to all retailers with the associated software and communications. Payment under the contract is based on 8.49% of net weekly Lottery sales of lotto and scratch games. The contract currently has a termination date of March 30, 2023.

10. LEASES/INSTALLMENT PURCHASES PAYABLE

Rent. The Montana Lottery leases its office, administrative and warehouse facilities under a lease agreement that is effective January 1, 2017 through August 2027. The monthly lease payment is \$18,068.

11. INVESTMENTS

Effective June 30, 2005, the State of Montana implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*. The Lottery participates in two investment pools: the Multi-State Lottery Association (MUSL) reserve accounts and the State of Montana's Short Term Investment Pool (STIP). The applicable investment disclosures are described in the following paragraphs.

Multi-State Lottery Association The MUSL investment policy for prize reserve and unreserved funds states that permitted investments "include direct obligations of the United States government, perfected repurchase agreements, and obligations issued or guaranteed as to payment of principal and interest by agencies or instrumentalities of the United States government, and mutual funds of approved investments".

Short-term Investment Pool The State's Short Term Investment Pool (STIP) is an external investment pool managed and administered under the direction of the Montana Board of Investments as statutorily authorized by the Unified Investment Program. It is a commingled external investment pool and participants may request for redemption on a daily basis. The fair values of the investments in this category have been determined using the NAV per share (or its equivalent) of the investment.

Credit risk is defined as the risk that an issuer of an investment will not fulfill its obligation, i.e., not make timely principal and interest payments. The STIP securities have credit risk as measured by major credit rating services, however, the pool is not rated. The Lottery does not have a policy regarding credit risk

Per MUSL, for 2017 the prize reserves held on behalf of the Montana Lottery are invested in the Montana Winners Trust. In this trust, 61% was invested in Federal Agencies; another 13% was invested in the First American Government Obligation Fund which is used for overnight investing and does not have a rating from S&P or Moodys, etc. However, it is a very conservatively managed vehicle, investing exclusively in short-term U.S. government securities. The other 26% of the prize reserves are invested in Federal Agency repurchase agreements secured by U.S. government securities. The Lottery does not have any authority or a policy regarding the investment portfolios.

Custodial credit risk is the risk that the Lottery would not be able to recover the value of the investment or collateral securities that are in the possession of an outside party in the event of the failure of that party.

The MUSL prize reserves are held in the Montana Winners Trust using policies set forth by the MUSL board regarding policies for the type of securities, as well as the custody, trading and the use of proceeds of the securities. The Lottery does not have any authority or a policy regarding the investment portfolios.

Concentration of credit is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Because STIP is a pooled investment, this risk does not apply. Because the MUSL reserves are also a pooled investment, this risk does not apply to them either.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Lottery does not have any authority or a policy regarding the investment portfolios.

The MUSL prize reserves are invested through the Montana Winners Trust with daily liquidity, and therefore, has no interest rate risk. The MUSL board's investment policy limits the individual security and the portfolio's maturity. As of June 30, 2017, the duration for the U.S. Government Treasury securities was a blended rate of 0.85 years.

The STIP securities are invested in various bond pools and investment portfolios which are liquid on a daily basis. Therefore, STIP, itself does not have this risk. The duration for this pool as of June 30, 2017 is 0.11 years.

According to the STIP Investment Policy, “the STIP portfolio will minimize interest rate risk by:

1. Structuring the investment portfolio so securities mature to meet cash requirements for ongoing operations, thereby normally avoiding the need to sell securities on the open market prior to maturity;
2. Maintaining a dollar-weighted average portfolio maturity (WAM) for 60 days or less (for this purpose, the date to the next coupon reset date will be used for all floating or variable rate securities); and
3. STIP will maintain a reserve account.”

12. FAIR VALUE MEASUREMENT

The Lottery categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles as follows:

Level 1 – Quoted prices for identical assets or liabilities in active markets.

Level 2 – Prices determined using inputs, other than quoted prices included within Level 1, that are observable for an asset or liability, either directly or indirectly.

Level 3 – Prices are determined using unobservable inputs.

Investments Measured at Net Asset Value

		Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable (Level 3)
	June 30, 2017			
<u>Investments by Net Asset Value</u>				
Short Term Investment Pool (STIP)	\$1,439,929			
Total Investments by net asset value level	<u>\$1,439,929</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Investments Measured at Net Asset Value

	June 30, 2016	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable (Level 3)
<u>Investments by Net Asset Value</u>				
Short Term Investment Pool (STIP)	\$1,428,495			
Total Investments by net asset value level	<u>\$1,428,495</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The Short Term Investment Pool (STIP) has a daily redemption frequency and a daily redemption notice period. The fair value of this pool has been determined using the Net Asset Value (or its equivalent).

13. OTHER POST EMPLOYMENT BENEFITS

General. The State of Montana and the Montana Lottery provide optional postemployment healthcare benefits in accordance with Montana Code Annotated, Title 2, Chapter 18, Section 704 to the following employees and dependents who elect to continue coverage and pay administratively established contributions: (1) employees and dependents who retire under applicable retirement provisions, and (2) surviving dependents of deceased employees. Medical, dental, and vision benefits are available through this plan.

Plan Description. The State OPEB plans are agent multiple employer plans. There are a number of State agencies who are participating employers under this plan. Each participating employer is required by GASB Statement No. 43 to disclose additional information regarding funding policy, the employer's annual OPEB cost and contributions made, the funded status and funding progress of the employer's individual plan, and actuarial methods and assumptions used.

The healthcare OPEB plans allow retirees to participate, as a group, at a rate that does not cover all of the related costs. This results in the reporting of an "implied rate" subsidy in the related financial statements and footnotes. While this liability is disclosed for financial statement purposes, it does not represent a legal liability of the State or any of

its component units. Accordingly, reported contributions are not a result of direct funding to the plans or for associated liabilities, but are a measure of the difference in retiree payments into the plans and actual medical costs associated with those individuals paid for by the plans. The healthcare OPEB plans are reported as agency funds. There are no assets or liabilities as only contributions collected and distributions made are reflected in these funds. See the funding policy that follows.

Bases of Accounting. OPEB is recorded on an accrual basis for all enterprise and internal service funds as well as component units. OPEB is recorded on a modified accrual basis for the governmental funds. Plan member contributions are recognized in the period in which the contributions are made. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

Funding Policy. The State of Montana pays for postemployment healthcare benefits on a pay-as-you-go basis. Montana Code Annotated, Title 2, Chapter 18, Part 8 gives authority for establishing and amending the funding policy to the Department of Administration. As of June 2017, the State plan's administratively established retiree medical premiums vary between \$439 and \$1,633 per month depending on the medical plan selected, family coverage, and Medicare eligibility. Administratively established dental premiums vary between \$41.10 and \$70.00 and vision hardware premiums vary between \$7.64 and \$22.26 depending on the coverage selected.

Annual Other Postemployment Benefit Cost and Contributions. The annual required contribution (ARC), an actuarially determined rate in accordance with the parameters of GASB Statement No. 45, represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed 30 years.

The following table presents the OPEB cost for the year, the amount contributed, and changes in the OPEB plans for fiscal year 2017 and 2016:

Year ended June 30,	2017	2016
Annual Required Contribution/OPEB Cost	\$ 82,900	\$ 83,228
Interest on net OPEB obligation	28,205	25,690
Amortization Factor	(22,122)	(20,149)
Annual OPEB cost	88,983	88,769
Retiree Claims Paid	(21,892)	(22,055)
Increase in net OPEB obligation	67,091	66,714
Net OPEB obligation – beginning of year	663,958	597,244
Net OPEB obligation – end of year	<u>\$731,049</u>	<u>\$663,958</u>

Since the plan pays other postemployment benefits on a pay-as-you-go basis, the funded ratio of the OPEB obligation is 0%.

The Lottery's annual healthcare OPEB cost, the percentage of annual implicit contributions toward the OPEB cost through retiree claims paid on their behalf, and the net OPEB obligation for the fiscal years 2017 through 2015 was as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/2017	\$88,983	24.6%	\$731,049
6/30/2016	\$88,769	24.8%	\$663,958
6/30/2015	\$90,075	28.2%	\$597,244

Actuarial Methods and Assumptions. The State is required by GASB Statement No. 45 to obtain an actuarial evaluation every other year. An actuarial report was prepared for December 31, 2015. Therefore, an actuarial evaluation was not prepared for December 31, 2014.

As of December 31, 2017, the Lottery's actuarially accrued liability (AAL) for benefits was \$917,328, with no actuarial value of assets, resulting in an unfunded actuarial liability (UAAL) of \$917,328, and the ratio of the UAAL to the covered payroll was 56.73%. The UAAL is being amortized as a level dollar amount over an open basis for 30 years.

In the December 31, 2015 actuarial valuation, the projected unit cost funding method was used for the State. The actuarial assumptions included a 4.25% discount rate and a 2.50% payroll growth rate. The projected annual healthcare cost trend rate is initially 3.4% for medical and 10.8% for prescription drugs. The decrease to the medical costs trend rate in plan year 2015 is based on actual trend data instead of estimated trend rates. The medical rate increases to an actuarially determined 9.5% in 2016. Both medical costs and prescription drugs are reduced by decrements to a rate of 5.0%, medical costs after eleven years and prescription drugs after six years.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revisions being actual results are compared with past expectations and new estimates are made about the future. Actuarial calculations reflect a long-term perspective.

The following schedule of funding progress is designed to present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial liabilities for benefits.

Date	Actuarial Value of Assets (A)	Actuarial		Funded Ratio (A/B)	Covered Payroll (C)	UAAL as a Percentage of Covered Payroll (B-A)/C
		Accrued Liability (AAL) (B)	Unfunded AAL (UAAL) (B-A)			
12/31/2009	\$ -	\$839,608	\$839,608	0.00%	\$1,373,902	61.11%
12/31/2011	\$ -	\$789,880	\$789,880	0.00%	\$1,370,886	57.62%
12/31/2013	\$ -	\$881,458	\$881,458	0.00%	\$1,402,639	62.84%
12/31/2015	\$ -	\$924,958	\$924,958	0.00%	\$1,613,698	57.32%
12/31/2017	\$ -	\$917,328	\$917,328	0.00%	\$1,617,009	56.73%

Projections of benefits for financial reporting progress are based on the substantive plan (*the plan as understood by the employer and the plan members*). This includes the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point.

The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future.

14. EMPLOYEE RETIREMENT PLAN

Plan Description. The PERS-Defined Benefit Retirement Plan (DBRP) and Defined Contribution Retirement Plan (DCRP) are administered by the Montana Public Employee Retirement Administration (MPERA), and are a multiple-employer, cost-sharing plans established July 1, 1945, and governed by Title 19, chapters 2 & 3, Montana Code Annotated (MCA). These plans cover the State, local governments, certain employees of the Montana University System, and school districts.

All new members are initially members of the PERS-DBRP and have a 12-month window during which they may choose to remain in the PERS-DBRP or join the PERS-DCRP by filing an irrevocable election. Members may not be members of both the *defined contribution* and *defined benefit* retirement plans.

The PERS-DBRP provides retirement, disability, and death benefits to plan members and their beneficiaries. Benefits are established by state law and can only be amended by the Legislature. Benefits are based on eligibility, years of service, and highest average compensation. Member rights are vested after five years of service.

Summary of Benefits. Member's highest average compensation (HAC)

Hired prior to July 1, 2011 - highest average compensation during any consecutive 36 months;

Hired on or after July 1, 2011 – highest average compensation during any consecutive 60 months;

Hired on or after July 1, 2013 – 110% annual cap on compensation considered as part of a member's highest average compensation.

Eligibility for benefit

Service retirement:

Hired prior to July 1, 2011: Age 60, 5 years of membership service;
Age 65, regardless of membership service; or
Any age, 30 years of membership service.

Hired on or after July 1, 2011: Age 65, 5 years of membership service;
Age 70, regardless of membership service.

Early retirement, actuarially reduced:

Hired prior to July 1, 2011: Age 50, 5 years of membership service; or
Any age, 25 years of membership service.

Hired on or after July 1, 2011: Age 55, 5 years of membership service.

Vesting; 5 years of membership service

Monthly benefit formula

Members hired prior to July 1, 2011:

- ♦ Less than 25 years of membership service: 1.785% of HAC per year of service credit;
- ♦ 25 years of membership service or more: 2% of HAC per year of service credit.
- ♦ Members hired on or after July 1, 2011:
- ♦ Less than 10 years of membership service: 1.5% of HAC per year of service credit;
- ♦ 10 years or more, but less than 30 years of membership service: 1.785% of HAC per year of service credit;
- ♦ 30 years or more of membership service: 2% of HAC per year of service credit.

Guaranteed Annual Benefit Adjustment (GABA)

- ♦ 3% for members hired **prior to** July 1, 2007
- ♦ 1.5% for members hired **on or after** July 1, 2007
- ♦ Members hired on or after July 1, 2013:
 - a. 1.5% for each year PERS is funded at or above 90%;
 - b. 1.5% is reduced by 0.1% for each 2% PERS is funded below 90%; and
 - c. 0% whenever the amortization period for PERS is 40 years or more.

After the member has completed 12 full months of retirement, the member's benefit increases by the applicable percentage each January, **inclusive** of other adjustments to the member's benefit.

Overview of Contributions.

Rates are specified by state law for periodic employer and employee contributions and are a percentage of the member's compensation. Contributions are deducted from each member's salary and remitted by participating employers. The State legislature has the authority to establish and amend contribution rates to the plan.

Member contributions to the system: a. Plan members are required to contribute 7.90% of member's compensation. Contributions are deducted from each member's salary and remitted by participating employers.

The 7.90% member contributions is temporary and will be decreased to 6.9% on January 1 following actuary valuation results that show the amortization period has dropped below 25 years and would remain below 25 years following the reduction of both the additional employer and additional member contribution rates.

Employer contributions to the system: State and University System employers are required to contribute 8.27% of members' compensation. Following the 2013 Legislative Session, PERS-employer contributions were temporarily increased. Effective July 1, 2013, employer contributions increased 1.0%. Beginning July 1, 2014, employer contributions increased an additional 0.1% a year over 10 years, through 2024. The employer additional contributions including the 0.27% added in 2007 and 2009, terminates on January 1 following actuary valuation results that show the amortization period of the PERS-DBRP has dropped below 25 years and would remain below 25 years following the reductions of both the additional employer and member contributions rates. Effective July 1, 2013, employers are required to make contributions on working retirees' compensation. Member contributions for working retirees are not required.

Stand-Alone Statements. The PERS financial information is reported in the Public Employees' Retirement Board's *Comprehensive Annual Financial Report* for the fiscal year ended. It is available from the PERB at 100 North Park, PO Box 200131, Helena MT 59620-0131, 406-444-3154.

CAFR information including the stand alone financial statements can be found at the MPERA's website, <http://mpera.mt.gov/annualReports.shtml>. The latest actuarial valuation and experience study can be found at the MPERA's website, <http://mpera.mt.gov/actuarialValuations.asp>.

Actuarial Assumptions. The Total Pension Liability as of June 30, 2017, is based on the results of an actuarial valuation date of June 30, 2015 with update procedures to roll forward the Total Pension Liability to June 30, 2017. There were several significant assumptions and other inputs used to measure the Total Pension Liability. The actuarial assumptions used in the June 30, 2016 valuation were based on the results of the actuarial experience study, dated May 2010 for the six year period July 1 2003 to June 30, 2009. Among those assumptions were the following:

- ♦ General Wage Growth 4.00% (includes Inflation at 3.00%)
- ♦ Merit Increases 0% to 6%
- ♦ Investment Return 7.75%
- ♦ Postretirement Benefit Increases; 3% for members hired prior to July 1, 2007,
- ♦ 1.5% for members hired on or after July 1, 2007, and for members hired on or after July 1, 2013;
 - a. 1.5% for each year PERS is funded at or above 90%;
 - b. 1.5% is reduced by 0.1% for each 2% PERS is funded below 90%; and
 - c. 0% whenever the amortization period for PERS is 40 years or more.

Mortality assumptions among contributing members, terminated vested members, service retired members and beneficiaries based on RP 2000 Combined Employee and Annuitant Mortality Tables projected to 2015 with scale AA. Mortality assumptions among Disabled Retirees are based on RP 2000 Combined Employee and Annuitant Mortality Tables with no projections. No future mortality improvement is assumed.

Discount Rate. The discount rate used to measure the Total Pension Liability was 7.75%. The projection of cash flows used to determine the discount rate assumed that contributions from participating plan members, employers, and non-employer contributing entities will be made based on the Board's funding policy, which establishes the contractually required rates under Montana Code Annotated. The State contributes 0.1% of salaries for local governments and 0.37% for school districts. In addition, the State contributes coal severance tax and interest money from the general fund. The interest is contributed monthly and the severance tax is contributed quarterly. Based on those assumptions, the System's fiduciary net position was projected to be adequate to make all the projected future benefit payments of current plan members through the year 2117. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the Total Pension Liability. No municipal bond rate was incorporated in the discount rate.

Target Allocations.

Asset Class	Target Asset Allocation	Long-Term Expected Real Rate of Return
Cash Equivalents	2.6%	4.00%
Domestic Equity	36.0%	4.55%
Foreign Equity	18.0%	6.35%
Fixed Income	23.4%	1.00%
Private Equity	12.0%	7.75%
Real Estate	8.0%	4.00%

The long-term expected return on pension plan assets is reviewed as part of the regular experience studies prepared for the System. The analysis performed for the period covering fiscal years 2003 through 2009, is outlined in a report dated May 2010, which is located on the MPERA website. Several factors are considered in evaluating the long-term rate of return assumption including rates of return adopted by similar public sector systems, and by using a building block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed by the investment consultant for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the

expected future real rates of return by the target asset allocation percentage and then adding expected inflation. The assumption is intended to be a long term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years.

Best estimates are presented as the arithmetic real rates of return for each major asset class included in the System's target asset allocation as of June 30, 2016, is summarized in the above table.

Sensitivity Analysis.

	1.0% Decrease (6.75%)	Current Discount Rate	1.0% Increase (8.75%)
Employer Net Pension Liability			
June 30, 2017	\$2,854,644	\$1,967,263	\$1,202,872
June 30, 2016	\$2,546,659	\$1,651,762	\$ 896,042

In accordance with GASB 68 regarding the disclosure of the sensitivity of the Net Pension Liability to changes in the discount rate, the above table presents the Net Pension Liability calculated using the discount rate that is 1.00% lower (6.75%) or 1.00% higher (8.75%) than the current rate.

Summary of Significant Accounting Policies. The Montana Public Employee Retirement Administration (MPERA) prepares its financial statements using the accrual basis of accounting. For the purposes of measuring the Net Pension Liability, deferred inflows of resources and deferred outflows of resources related to pensions, Pension Expense, information about the fiduciary net position and additions to/deductions from fiduciary net position have been determined on the same accrual basis as they are reported by MPERA. For this purpose, member contributions are recognized in the period in which contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Revenues are recognized in the accounting period they are earned and become measurable. Benefit payments and refunds are recognized in the accounting period when due and payable in accordance with the benefit terms. Expenses are recognized in the period incurred. Investments are reported at fair value. MPERA adheres to all applicable Governmental Accounting Standards Board (GASB) statements.

Net Pension Liability. In accordance with GASB Statement 68, Accounting and Financial Reporting for Pensions, employers are required to recognize and report certain amounts associated with their participation in the Public Employees' Retirement System (PERS). Statement 68 became effective for fiscal year ended June 30, 2015 and includes requirements to record and report their proportionate share of the collective Net Pension Liability, Pension Expense, Deferred Inflows and Deferred Outflows of resources associated with pensions.

In accordance with Statement 68, PERS has a special funding situation in which the State of Montana is legally responsible for making contributions directly to PERS on behalf of the employers. Due to the existence of this special funding situation, local governments and school districts are required to report the portion of the State of Montana's proportionate share of the collective Net Pension Liability that is associated with the non-State employer. The State of Montana also has a funding situation that is not Special Funding whereby the State General Fund provides contributions from the Coal Severance Tax and interest. All employers are required to report the portion of Coal Tax Severance Tax and interest attributable to the employer.

Lottery Proportionate Share of Net Pension Liability:

Net Pension Liability as of 6/30/17	Net Pension Liability as of 6/30/16	Percent of Collective NPL as of 6/30/17	Percent of Collective NPL as of 6/30/16	Change in Percent of Collective NPL
\$1,967,263	\$1,651,762	0.115492%	0.118163%	(0.002671%)

At June 30, 2017, the Lottery recorded a liability of \$1,967,263 for its proportionate share of the Net Pension Liability. The Net Pension Liability was measured as of June 30, 2016, and the Total Pension Liability used to calculate the Net Pension Liability was determined by an actuarial valuation as of June 30, 2015, with roll forward provisions to June 30, 2016. For the fiscal years ended June 30, 2017, and 2016, the employer's proportion of the Net Pension Liability was based on the employer's contributions received by PERS during the measurement periods July 1, 2015 to June 30, 2016. Relative to the total employer contributions received from all of PERS' participating employers, at June 30, 2017, the Lottery's proportion was 0.115492%.

Changes in actuarial assumptions and methods: There were no changes in assumptions or other inputs that affected the measurement of the Total Pension Liability.

Changes in benefit terms: There have been no changes in benefit terms since the previous measurement date.

Changes in proportionate share: There were no changes between the measurement date of the collective Net Pension Liability and the employer's reporting date that are expected to have a significant effect on the employer's proportionate share of the collective net pension liability.

Pension Expense. At June 30, 2017, the Lottery recognized \$179,560 for its proportionate share of the Plan's pension expense and recognized grant revenue of \$0 for the state of Montana proportionate share of the pension expense associated with the Lottery. Additionally, the employer recognized grant revenue of \$34,467 from the Coal Severance Tax Fund.

Recognition of Deferred Inflows and Outflows. At June 30, 2017 and 2016, the Lottery reported its proportionate share of PERS' deferred outflows of resources and deferred inflows of resources related to PERS from the following sources:

June 30, 2017

	Deferred Outflows of Resources	Deferred Inflows of Resources
Actual vs. Expected Experience	\$ 10,615	\$ 6,512
Changes in Assumptions	\$185,080	\$ -
Actual vs. Expected Investment Earnings	\$ -	\$ -
Changes in Proportion Share and Differences between Employer Contributions and Proportionate Share of Contributions	\$ -	\$ 5,343
Employer contributions subsequent to the measurement date – FY 2017 contributions	\$124,362	\$ -
Total	\$320,057	\$11,855

June 30, 2016

	Deferred Outflows of Resources	Deferred Inflows of Resources
Actual vs. Expected Experience	\$ -	\$ 9,489
Changes in Assumptions	\$ -	\$ -
Actual vs. Expected Investment Earnings	\$ -	\$132,784
Changes in Proportion Share and Differences between Employer Contributions and Proportionate Share of Contributions	\$ 95,212	\$ -
Employer contributions subsequent to the measurement date – FY 2016 contributions	\$123,235	\$ -
Total	\$218,447	\$142,273

Amounts reported as deferred outflows of resources related to pensions resulting from the Lottery's contributions subsequent to the measurement date will be recognized as a reduction of the Net Pension Liability in each year end. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in Pension Expense as follows:

Year Ended June 30,	Amount Recognized in Pension Expense as an Increase or (decrease) to Pension Expense
2017	\$ 8,961
2018	\$ 8,961
2019	\$ 105,174
2020	\$ 66,088
2021	\$ 0
Thereafter	\$ 0

Report on Internal Control and Compliance

LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



B-1

Deputy Legislative Auditors
Cindy Jorgenson
Joe Murray

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Legislative Audit Committee
of the Montana State Legislature:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Montana State Lottery (lottery), as of and for the fiscal years ended June 30, 2017, and 2016, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements, and have issued our report thereon dated February 13, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the lottery's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of lottery's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal controls was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify

any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the lottery's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the lottery's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the lottery's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,

/s/ *Cindy Jorgenson*

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

February 13, 2018

MONTANA STATE LOTTERY

LOTTERY RESPONSE



February 27, 2018

RECEIVED

FEB 28 2018

LEGISLATIVE AUDIT DIV.

Angus Maciver
Legislative Auditor
Legislative Audit Division
Room 135, State Capitol
Helena, MT 59620

Dear Mr. Maciver:

I would like to thank the Legislative Audit staff for their assistance and work performed on the Montana Lottery Financial-Compliance Audit for the two fiscal years ended June 30, 2017. We appreciate the services your staff provide in reviewing the Lottery's procedures, internal controls, accounting practices, and the accuracy of the financial statements. We feel this audit was productive and helpful in our continued endeavors to improve the financial reporting of the agency.

I am available to answer questions or provide further information that you or the Legislative Audit Committee may require.

Sincerely,

A handwritten signature in black ink, appearing to read "Angela Wong", is written over the printed name.

Angela Wong
Director
Montana Lottery